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No. 90-1943

Supreme Court, U.S.
FILED
AUG 1 1991
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

IN RE PRUDENTIAL LINES, INC.,
Debtor.

PSS STEAMSHIP COMPANY, INC.,
Petitioner,

v.

THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS,

and

COLD SPRING SHIPPING, L.P.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF RESPONDENTS IN OPPOSITION

ALLAN L. GROPPER
WHITE & CASE
1155 Avenue of the Americas
New York, New York 10036
(212) 819-8200
Counsel for Respondent
The Official Committee
of Unsecured Creditors

MAX O. TRUITT, JR.
Counsel of Record
LOUIS R. COHEN
BRYAN E. SLONE
SHARON A. POCOCK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037
(202) 663-6000
Counsel for Respondent
Cold Spring Shipping, L.P.

August 1, 1991

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether a net operating loss generated by a corporate debtor in its pre-petition operations is "property" of the debtor's bankruptcy estate within the meaning of section 541 of the Bankruptcy Code and therefore protected by the automatic stay.

2. Whether it was proper for the Bankruptcy Court to enjoin petitioner from taking a worthless-stock deduction for tax year 1988, when that deduction, if ever taken for that year, would effectively eliminate the debtor's net operating loss.

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BRIEF OF RESPONDENTS IN OPPOSITION

STATUTES INVOLVED

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11 U.S.C. § 362—Petitioner's Appendix (P. App.) 82a

11 U.S.C. § 541—P. App. 84a

26 U.S.C. § 382—R. App. 4a

STATEMENT

The issue in this case is whether a valuable asset of a corporate debtor, a net operating loss ("NOL") attributable to losses generated by the debtor in its pre-bankruptcy operations, belongs to the debtor's sole stockholder, the petitioner here, or to the debtor for the benefit of its creditors, as common sense suggests and the court of appeals ruled.

Prudential Lines, Inc. ("PLI" or the "debtor") was at all relevant times a wholly owned subsidiary of petitioner PSS Steamship Company, Inc. PLI operated as a United States flag shipping company with offices in major United States, European, and Middle Eastern ports. Petitioner was a member of an affiliated group for federal income tax purposes that included PLI. The affiliated group had filed consolidated federal income tax returns since 1976.

On September 12, 1986, an involuntary Chapter 11 petition was filed against PLI in the United States Bankruptcy Court for the Southern District of New York; PLI subsequently consented to an order for relief. Respondent Official Committee of Unsecured Creditors (the "Committee") is a committee established pursuant to 11 U.S.C. § 1102 to represent the interests of unsecured creditors in the PLI bankruptcy case. Respondent Cold Spring Shipping, L.P. ("Cold Spring") is a limited partnership that held a participation interest in a large unsecured claim in the PLI bankruptcy case.[1]

After the debtor was unsuccessful in garnering support for its own plan of reorganization, respondents submitted a joint plan of reorganization for creditor approval in mid-1989.[2] One asset important to the reor-

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[1] Respondents are not corporations, and therefore there are no parent companies or subsidiaries to be disclosed pursuant to Rule 29.1 of the Rules of this Court.

[2] On December 15, 1989, the joint plan was confirmed by the bankruptcy court. Pursuant to the joint plan, the stock of the

ganization of the debtor was the debtor's approximately $74 million NOL, generated by the debtor's pre-petition operations. It is undisputed that this NOL would, but for the steps threatened by petitioner as described in the following paragraph, be available to the reorganized debtor.

In November 1989, as the creditors were about to vote on the joint plan, petitioner announced its intention to file a federal income tax return for 1988 claiming a worthless-stock deduction with respect to its ownership of all the stock of the debtor. It is undisputed that petitioner's taking of the worthless-stock deduction would have effectively eliminated the debtor's NOL.[3] Nonethe-

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reorganized debtor was issued to creditors (or to a trust for the benefit of creditors) and the reorganized debtor ceased to be a member of the affiliated group for federal income tax purposes.

[3] Under section 382 of the Internal Revenue Code, 26 U.S.C. § 382 (1988), a "change of ownership" of a corporation results in an annual limitation on the corporation's NOL generally equal to the value of the corporation's stock before the ownership change times a prescribed rate of return. Under Section 382(g)(4)(D) of the Internal Revenue Code, an ownership change is deemed to occur on the last day of the tax year in which a majority shareholder declares its stock in a corporation to be worthless by claiming a worthless-stock deduction. Thus, petitioner, by claiming a worthless-stock deduction for tax year 1988 would have triggered a deemed ownership change on December 31, 1988, and would have effectively eliminated PLI's NOL as of that date. *See* P. App. at 45a n.2, 63a-64a n.18 (bankruptcy court's explanation).

Section 382(g)(4)(D) is intended to preclude a corporate shareholder from claiming that a subsidiary corporation is worthless and later (directly or indirectly) enjoying the use of the subsidiary corporation's NOL. Ways and Means Committee Report on H.R. 3545, 100th Cong., 1st Sess. 1096 (1987). Petitioner's worthless-stock deduction would not have affected the debtor's NOL if the deduction were taken in any year other than 1988. Section 382(g)(4)(D) does not apply to tax years prior to 1988. Nor would section 382(g)(4)(D) apply if petitioner took its worthless-stock deduction in 1989, the year in which the joint plan of reorganization was confirmed. Section 382(g)(4)(D) applies only where the majority shareholder holds the stock at the close of its taxable year. PLI stock passed to PLI creditors at the time of confirma-

less, petitioner never moved for relief from the application of the automatic stay.

On November 13, 1989, to prevent petitioner from eliminating the NOL available to the debtor's creditors in the plan of reorganization, respondents filed an adversary complaint against petitioner in bankruptcy court seeking declaratory and injunctive relief. The pertinent count of the complaint asserted that petitioner's threatened action would violate the automatic stay provision, 11 U.S.C. § 362, because it would destroy property of the debtor's bankruptcy estate, namely PLI's NOL.[4]

On November 13, 1989, the bankruptcy court granted a temporary restraining order against the petitioner. After a day-long evidentiary hearing, on December 4, 1989, the bankruptcy court granted a preliminary injunction, holding that the debtor's NOL, attributable to the pre-bankruptcy operations of the debtor, was property of the bankruptcy estate protected by the automatic stay. P. App. 41a. On December 19, 1989, four days after the confirmation of the joint plan, the bankruptcy court issued a second opinion explaining the scope and nature of the injunction: the court permanently enjoined petitioner from taking a worthless-stock deduction for tax year 1988 but did not prohibit petitioner from taking the deduction in any other year. P. App. 31a.

Petitioner appealed to the district court. On September 28, 1990, the district court entered an order affirming

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tion of the joint plan in December 1989 and therefore, a worthless-stock deduction in that tax year would not have had adverse repercussions for the debtor under section 382(g)(4)(D).

[4] Two other counts of the complaint alleged that petitioner's threatened action would violate the fiduciary duty it owed to its insolvent subsidiary, PLI, and to PLI's creditors, and that petitioner's proposed action was in bad faith. The bankruptcy court denied relief on these counts; respondents cross-appealed from this ruling, but neither the district court nor the court of appeals reached the merits of these claims.

the bankruptcy court's entry of a permanent injunction. P. App. 23a.

On March 20, 1991, a unanimous panel of the Court of Appeals for the Second Circuit affirmed the district court's ruling. P. App. 1a. The Second Circuit held, first, that the debtor's NOL was property of the bankruptcy estate within the meaning of 11 U.S.C. § 541, protected by the automatic stay, 11 U.S.C. § 362. The Second Circuit then held that it was proper for the bankruptcy court to enjoin petitioner permanently, pursuant to 11 U.S.C. § 105, from taking a worthless-stock deduction for tax year 1988, in order to prevent destruction of an asset of the estate, the loss of which would impede the debtor's reorganization.

ARGUMENT

I. THE SECOND CIRCUIT'S RULING THAT THE DEBTOR'S NET OPERATING LOSS WAS PROPERTY OF THE BANKRUPTCY ESTATE WAS A STRAIGHTFORWARD AND CORRECT APPLICATION OF SECTION 541 OF THE BANKRUPTCY CODE, DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT OR ANY OTHER COURT OF APPEALS, AND PRESENTS NO ISSUE MERITING REVIEW.

The court of appeals correctly ruled that a net operating loss—whether a carryback or a carryforward [5]—is property of the corporate debtor. Tax law and bankruptcy law together make it clear that a corporate debtor's NOL belongs to the corporate debtor during and after its reorganization under Chapter 11.

The court of appeals recognized that "[t]he nature and extent of the debtor's interest in property is determined by applicable non-bankruptcy law" but that "[w]hether

[5] Generally, net operating losses of a corporation may be carried back three years and carried forward fifteen years to offset otherwise taxable income. 26 U.S.C. § 172(b) (1988).

that interest is included in the property of the debtor's estate is determined by bankruptcy law." P. App. 9a (citations omitted). Using this analytical framework, the court of appeals first addressed the question whether the debtor had an interest in the NOL generated by its own operations and correctly concluded that "at the commencement of the bankruptcy case against it, PLI had an interest in the $74 million NOL attributable to its pre-bankruptcy operation." P. App. 13a.

The tax law and regulations thereunder are clear in providing that, in a bankruptcy proceeding like the present case, a corporate debtor's interest in its NOL is not only retained by the debtor but should be preserved for the benefit of the creditors. In this case, both the petitioner's and respondents' plans of reorganization proposed during the bankruptcy proceeding would have resulted in PLI's ceasing to be owned by PSS and thereby ceasing to be a member of the affiliated group for tax purposes. In fact, the certainty of this disaffiliation was essential to petitioner's worthless-stock claim.[6] The regulations for affiliated groups, however, clearly provide that when a subsidiary leaves an affiliated group, the subsidiary's portion of the aggregate NOL of the affiliated group is retained by the former subsidiary and is not allocated to its parent or to other members of the consolidated group.[7]

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[6] The IRS has ruled that where there are prospects for reorganization of the debtor, a worthless-stock deduction may not be claimed until there is no reasonable prospect that the shareholder will be allocated any stock of the reorganized debtor. Rev. Rul. 77-17, 1977-1 C.B. 44, 46, *citing Lawson v. Commissioner*, 42 B.T.A. 1103 (1940), *acq.*, 1940-1 C.B. 7.

[7] Contrary to petitioner's contention, tax law makes it clear that, in the circumstances of the present case, an NOL carryforward belongs to the corporation that has generated the NOL, not to its corporate parent. When a subsidiary leaves a consolidated group, the subsidiary's portion of the consolidated group's NOL carryovers at the time of its departure belongs to the subsidiary, not to its parent or to other members of the consolidated group. Treas. Reg. § 1.1502-79(a)(1)(ii) (Proposed rule change

Thus, PLI clearly had a valuable continuing interest in the NOL.

It is also clear that Congress intended that in a qualified bankruptcy reorganization a corporate debtor's NOL would be retained by the reorganized debtor for the specific benefit of the creditors. The reorganization plan proposed by respondents and confirmed by the bankruptcy court was designed to qualify under the special bankruptcy reorganization exception to the normal NOL limitations following an ownership change. Under this statutory exception, section 382(*l*)(5) of the Internal Revenue Code,[8] the NOL of a corporate debtor is retained by the reorganized debtor, subject to certain reductions, for the benefit of the reorganized debtor and its creditors.[9] The

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published at 49 Fed. Reg. 30536 (July 31, 1984) would redesignate subsection (1)(ii) as (1)(iii).). During a bankruptcy proceeding where potential reorganization plans would result in a debtor-subsidiary's leaving a consolidated group because the old equity owners do not retain 80 percent ownership, the debtor-subsidiary has a valuable future interest in its own NOL carryforwards pursuant to this allocation rule.

On March 14, 1990, the IRS issued proposed regulations that would prohibit a parent corporation from recognizing a loss on the disposition of subsidiary stock. Those regulations provide a special rule that would permit a parent corporation to reattribute a subsidiary's NOLs back to the parent to the extent such loss was disallowed. 55 Fed. Reg. 9426 (1990). On November 19, 1990, the IRS clarified that under this reattribution rule, the "[l]osses of a subsidiary may not be reattributed . . . to the extent that the subsidiary . . . [is] insolvent . . . at the time of the disposition." Prop. Treas. Reg. § 1.1502-20(g)(2) in 55 Fed. Reg. 49075, 49088 (1990). In making this clarification, the IRS expressly provided that "[t]o the extent of its insolvency, *the subsidiary's losses are not reattributable because they are deemed to be borne by creditors.*" 55 Fed. Reg. at 49082 (emphasis added).

[8] 26 U.S.C. § 382(l)(5) (Supp. 1990).

[9] In legislative history of section 382(*l*)(5) it was noted:

> Under the general rule of the Act, no carryforwards would be usable after the acquisition of an insolvent corporation

court of appeals thus correctly concluded that PLI had an interest in the NOL attributable to its own operations.

The court next considered whether such an interest was "property" within the meaning of the Bankruptcy Code and concluded that it was. This conclusion is also plainly correct. Section 541 of the Bankruptcy Code provides that the bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1), P. App. 84a. The court of appeals recognized that "[i]n construing this section, . . . Congress intended § 541 to be interpreted broadly," citing this Court's decision in *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983), P. App. 8a-9a.[10] Consistently with the breadth of

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> because the corporation's value immediately before the acquisition would be zero. In such a case, however, the loss corporation's creditors are the true owners of the corporation, although it may be impossible to identify the point in time when ownership shifted from the corporation's shareholders. Relief from a strict application of the general rule is provided, as the creditors of an insolvent corporation frequently have borne the losses reflected in an NOL carryforward.

JCS-10-87, General Explanation of the Tax Reform Act of 1986, 99th Cong., 2d Sess. 299 (May 4, 1987) (citation omitted).

[10] In defining "property" as it did in the Bankruptcy Code, Congress intended to "bring anything of value that the debtors have into the estate." H.R. Rep. No. 595, 95th Cong., 1st Sess. 176 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6136. The House Report commented:

> This includes all interests, such as interests in real or personal property, tangible and intangible property, choses in action, causes of action, rights such as copyrights, trade-marks, patents, and processes, contingent interests and future interests, whether or not transferable by the debtor.

Id. at 175-76. The Senate Report indicated that "property" under the Code was to be even broader than the definition under the predecessor Bankruptcy Act:

> The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of action . . . and all other forms of property currently specified

the Bankruptcy Code's definition of property, courts have had no reluctance to hold that various intangible and contingent rights are property of the bankruptcy estate.[11] The court of appeals' conclusion that "[t]he speculative nature of carryforwards does not place them outside the definition of property of the estate" (P. App. 15a.) is consistent with the breadth of the statutory definition and with case law interpreting the statute.

Petitioner argues that *Segal v. Rochelle*, 382 U.S. 375 (1966), and its codification in the Bankruptcy Code somehow imply that an NOL carryforward is not property of the bankruptcy estate of a corporate debtor. They do nothing of the kind. To the extent that *Segal* is relevant to the present case, it is entirely consistent with the holding of the court of appeals.

In *Segal*, decided under the Bankruptcy Act, this Court held that a net operating loss carry*back was* "property of the estate" of a bankrupt *individual.* This Court based its decision in *Segal* on the "thrust of § 70a(5) [the provision defining property in the Bankruptcy Act, predecessor of section 541 of the Bankruptcy Code] . . . to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition

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> in section 70a of the Bankruptcy Act § 70a, as well as property recovered by the trustee under section 542 of proposed Title 11. . . .

S. Rep. No. 989, 95th Cong., 2d Sess. 82, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5868.

[11] *See In re Gull Air, Inc.*, 890 F.2d 1255 (1st Cir. 1989) (gate slot is property); *In re Fugazy Express, Inc.*, 114 Bankr. 865 (Bankr. S.D.N.Y. 1990) (FCC license was property of estate), *aff'd*, 124 Bankr. 426 (S.D.N.Y. 1991); *In re Brown Transport Truckload, Inc.*, 118 Bankr. 889 (Bankr. N.D. Ga. 1990) (state grant of operating authority was property of estate); *In re McClain Airlines, Inc.*, 80 Bankr. 175 (Bankr. D. Ariz. 1987) (gate slot was property of estate); *see also In re Colonial Realty Co.*, 122 Bankr. 1 (Bankr. D. Conn. 1990) (debtor's property management agreement was property of estate).

. . . . [A]n interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed." 382 U.S. at 379.

Segal stopped short of holding that loss carry*forwards* were also property of the bankruptcy estate of an *individual.* The Court said "a carryover into post-bankruptcy years can be distinguished conceptually as well as practically" from a carryback because of the "inconvenience and hindrance [that] might be caused for the bankrupt individual" in keeping open the estate for the possible carryover period. 382 U.S. at 381. The Court did not discuss NOLs of a *corporate* debtor, and there is no reason to believe that the Court would have had any misgivings about treating carryforwards as property of a corporate debtor.

The bankruptcy estate of an individual was, under the Bankruptcy Act, and still is, under the Code, a taxable entity separate from the individual bankrupt, 11 U.S.C. § 346(b)(1) (1988), and the policy of the bankruptcy law was and is to give an individual a "fresh start." Since the value of carryforwards can only be determined with the passage of time, it would be necessary to keep the estate open to see what value the carryforwards would have to the estate. As the Court noted in *Segal,* keeping a bankruptcy case open in order to realize the value of carryforwards would necessarily delay settlement of the debtor's affairs and implementation of the discharge provisions that provide the individual debtor with his "fresh start." As the court of appeals noted here, "[t]o address the *Segal* Court's concern that including carryforwards as property of the estate would jeopardize the fresh start policy, Congress provided [in the Bankruptcy Code] that unutilized tax attributes revert to the debtor at the conclusion of the case. 11 U.S.C. § 346(i)(2) (1988)." P. App. 16a-17a.

None of this is applicable to corporate debtors. While the fresh start policy is important for the individual

debtor, affording the debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt," *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934), it is well established that the "fresh start policy does not apply to corporations." [12] For a corporation, "there is no comparable distinction between 'existing' and 'future' assets either in theory or in practice." [13] The bankruptcy estate of a corporate debtor is *not* a separate entity for tax purposes. A corporation remains the same taxable entity before, during, and after a bankruptcy proceeding. Thus, the estate does not have to remain open in order to realize the value of the carryforwards, because the corporations may use them during or after the bankruptcy, with the same resultant value to creditors.

Accordingly, all rulings since *Segal* have been consistent with the principal that net operating loss carryforwards of a corporation can be property of the estate under the Bankruptcy Act and the Bankruptcy Code. For example, the Eighth Circuit, in a case decided under current bankruptcy law, recently held that a net operating loss carryforward is property of the bankruptcy estate. *In re Russell*, 927 F.2d 413, 417-18 (8th Cir. 1991).[14]

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[12] Note, *Bankruptcy and the Union's Bargain: Equitable Treatment of Collective Bargaining Agreements*, 39 Stan. L. Rev. 1015, 1025 n.67 (1987).

[13] Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 110 n.45 (1984).

[14] *See also In re Beery*, 116 Bankr. 808 (D. Kan. 1990) (holding that, in light of *Segal v. Rochelle* and the circumstances of the case, a net operating loss carryforward was property of an individual's bankruptcy estate under the Bankruptcy Act); *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262, 264 (9th Cir.), *cert. denied*, 412 U.S. 919 (1973) ("[A]t the date of the filing of the petition in bankruptcy, [a] Trustee acquire[s] any interest the bankrupt ha[s] in the carryback tax refund," *citing Segal v. Rochelle*); *In re Koscot Interplanetary, Inc.*, 76-1

Petitioner next argues that in enacting the Bankruptcy Code, Congress determined that an NOL should be considered property of the estate of an individual debtor but not of a corporate debtor. Petitioner bases this conclusion on its examination of section 346(i)(1)(c) of the Bankruptcy Code, which expressly provides that in a case involving an individual, the estate succeeds to the debtor's tax attributes, including "any loss carryover." 11 U.S.C. § 346 (Supp. 1990). Because section 346(i) applies only to individual debtors, petitioner argues that Congress intended to bar the estates of corporate debtors from similarly succeeding to loss carryovers.

But as the court of appeals noted, two other subsections of section 346, sections 346(h) and (j), "contemplate use of NOL carryforwards by a corporate debtor." P. App. 17a. Section 346(h) discusses the determination of periods in which any debtor may use "a loss carryover or a loss carryback." Section 346(j) limits the use that debtors—corporate or individual—may make of NOLs by providing that "any net operating loss *of an individual or corporate debtor, including a net operating loss carryover to such debtor*, shall be reduced by the amount of indebtedness forgiven or discharged . . . ." 11 U.S.C. § 346(j)(3) (1988) (emphasis added). It could hardly be clearer that the Bankruptcy Code contemplates that NOL carrybacks and carryforwards are property of the estate of a corporate debtor.[15]

U.S.T.C. (CCH) ¶ 9442, at 84,186 (M.D. Fla. 1976) ("[*S*]*uch 'net operating loss' could qualify as a 'property' within the meaning of Sec. 70(a) of the Bankruptcy Act*").

[15] PSS misreads *Davis v. Commissioner*, 69 T.C. 814 (1978), as support for its position when, in fact, the case includes language quite contrary to petitioner's argument. Under the rationale of *Segal*, the Tax Court in *Davis* agreed that the NOLs did not become property of the estate of the individual debtors under the Bankruptcy Act, but remained with the individual debtors. What is important to this case is the Tax Court's observation:

> We recognize that net operating losses of corporations may be transferred and absorbed by successor corporations under

Petitioner also argues that an NOL is not the property of the debtor whose operations have generated the NOL but of the parent company that is responsible for filing the consolidated federal income tax return for the affiliated group and, in ordinary circumstances, decides how all NOLs of members of the affiliated group will be used. The court of appeals properly rejected this attempt to seize a valuable asset for the benefit of the debtor's stockholder rather than the debtor's creditors:

> The fact that a subsidiary's NOL ultimately may be used to offset another corportion's income does not mean that the subsidiary loses any interest in its NOL. The common parent acts as an agent on behalf of all the members of the consolidated group "for the convenience and protection of [the] IRS only." . . . [T]he property interests of the subsidiaries are not absorbed by the common parent. . . . It follows that a corporation does not lose any interest it had in the right to use its NOL to offset income because of its status in a group of affiliated corporations that file a consolidated tax return.

P. App. 12a-13a (citations omitted). And the consolidated return regulations, cited at footnote seven, *supra*, make it clear that when consolidation is broken, a departing subsidiary takes its share of the NOL with it.

Petitioner cites cases discussing a company's obligation to pay compensation to an affiliated company that generated an NOL that is used to offset the first com-

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limited circumstances (secs. 269, 381, and 382), but Congress has not seen fit to provide for the transfers of net operating losses by or to individuals.

69 T.C. at 830.

Thus, even *Davis*, upon which Petitioner erroneously relies to support its argument, indicates the long-standing policy of tax and bankruptcy law, working together, that allows a corporation reorganized in bankruptcy to retain its NOLs.

pany's income on a consolidated return.[16] As the Second Circuit said, these cases "stand for the proposition that one member of an affiliated group does not [in the absence of intercompany contract] have to compensate another member for tax benefits accruing to it through the use of the other member's NOL." P. App. 11a. The court of appeals properly rejected the application of these cases to the present case on the ground that they were decided "under fiduciary duty and contract standards," *Id.*, and "none purported to determine whether the NOL attributable to the bankrupt corporation was property of that corporation's bankruptcy estate." P. App. 12a.[17]

In sum, the court of appeals' holding that PLI's NOL is property of the corporate bankruptcy estate was correct, is entirely consistent with the decisions of this Court in *Segal* and *Whiting Pools* and with lower court decisions interpreting section 541 of the Bankruptcy Code.

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[16] PSS cites or discusses *Western Pac. R.R. Corp. v. Western Pac. R.R. Co.*, 197 F.2d 994 (9th Cir. 1951), *vacated and remanded on other grounds*, 345 US. 247, *reh'g denied* 206 F.2d 495 (9th Cir.), *cert. denied*, 346 U.S. 910 (1953); *Meyerson v. El Paso Natural Gas Co.*, 246 A.2d 789 (Del. Ch. 1967); *Case v. New York Cent. R.R.*, 15 N.Y.2d 150, 204 N.E.2d 643, 256 N.Y.S.2d 607 (1965); *Jump v. Manchester Life & Casualty Management Corp.*, 438 F. Supp. 185 (E.D. Mo. 1977), *aff'd*, 579 F.2d 449 (8th Cir. 1978); *In re Coral Petroleum, Inc.*, 60 Bankr. 377 (Bankr. S.D. Tex. 1986); *M & M Transp. Co. v. U.S. Indus., Inc.*, 416 F. Supp. 865 (S.D.N.Y. 1976); *In re All Prods. Co.*, 32 Bankr. 811 (Bankr. E.D. Mich. 1983).

[17] Petitioner also asserts, P. Br. 15-16, that its own worthless-stock deduction is not property of the bankruptcy estate. This argument is of course beside the point. The question argued and decided in the lower courts was whether the debtor's NOL was property of the bankruptcy estate.

II. THE BANKRUPTCY COURT CORRECTLY ENJOINED PETITIONER FROM EVER TAKING A WORTHLESS-STOCK DEDUCTION FOR TAX YEAR 1988, AND THE COURT OF APPEALS' AFFIRMANCE OF THAT INJUNCTION DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT OR ANY OTHER COURT OF APPEALS AND DOES NOT PRESENT ANY ISSUE MERITING REVIEW.

On December 19, 1989, the Bankruptcy Court permanently enjoined petitioner from taking a worthless-stock deduction for tax year 1988. The Second Circuit held that the permanent injunction was proper under section 105(a) of the Bankruptcy Code. This decision was correct and is consistent with previous decisions of this Court and other courts of appeals.

Having determined that PLI's NOL was a valuable asset which the reorganized debtor was entitled to use, the Bankruptcy Court was fully authorized to enjoin petitioner from acting in a way that would have led to the destruction of that asset, particularly since the net effect of petitioner's action would have been to place the debtor's shareholder (petitioner) ahead of its creditors. There is ample precedent for enjoining a person from an otherwise lawful action that injures property of the bankruptcy estate: "If action taken against the non-bankrupt party would inevitably have an adverse impact on property of the bankrupt estate, then such action should be barred by the automatic stay." *In re 48th Street Steakhouse, Inc.*, 835 F.2d 427, 431 (2d Cir. 1987), *cert. denied*, 486 U.S. 1035 (1988) (lessor's lease termination notice to cancel lease violated automatic stay because, if successful, termination of the lease would result in the destruction of debtor's subtenancy); *see also In re Bialac*, 712 F.2d 426 (9th Cir. 1983) (debtor's redemption interest in note, of which he owned only one-sixth interest, prevented foreclosure of the remaining five-sixths of the

note because such foreclosure would have cut off debtor's right of redemption).[18]

Petitioner's proposed deduction claim would violate the automatic stay because it could have eliminated the debtor's NOL, thus interfering with the estate's control of that property. Petitioner was correctly enjoined from seizing the value of the debtor's NOL for the debtor's sole stockholder—petitioner—and thereby denying that value to the debtor's creditors. Moreover, since the petitioner never sought relief from the automatic stay prior to the confirmation of the joint plan, this is a particularly appropriate result following the reorganization of the debtor.

As the Second Circuit noted, under section 105 of the Bankruptcy Code, a bankruptcy court has the equitable power to issue any order to carry out the provisions of the Code. This provision has been construed liberally to "enjoin [actions] that might impede the reorganization process." P. App. 21a. Numerous injunctions have been entered to prevent interference with a plan of reorgani-

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[18] In certain circumstances, bankruptcy courts will enjoin actions against nondebtor affiliates or principals of a debtor where such actions could irreparably harm the debtor's ability to reorganize. *See, e.g., In re Arrow Huss, Inc.*, 51 Bankr. 853 (Bankr. D. Utah 1985) (suits by credit card companies against debtor's principals for debts incurred on behalf of debtor enjoined for 45 days to allow principals to devote their efforts to the bankruptcy case); *In re Kasual Kreation, Inc.*, 54 Bankr. 915 (Bankr. S.D. Fla. 1985) (suits on personal guaranty by debtor's principal enjoined for 90 days where success during the Christmas season was essential to the success of the reorganization, and the time and energy of the debtor's principal would be required during that time); *In re Old Orchard Investment Co.*, 31 Bankr. 599 (W.D. Mich. 1983) (proceedings by a creditor against debtor partnership's general partner, secondarily liable for debts of partnership, were enjoined because of irreparable harm to debtor when partners are sued in their capacity as general partners: assets of general partners are part of the general fund to which all partnership creditors look to satisfy partnership debts).

zation.[19] The Second Circuit's affirmance of the bankruptcy court's decision to enjoin petitioner from taking a worthless-stock deduction for 1988, on the ground that that action would eliminate an asset of the PLI estate, was correct and does not conflict with any decision of this Court or any decision of another court of appeals.[20]

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[19] Bankruptcy courts may issue injunctions to prevent interference with a plan of reorganization. *See, e.g., Continental Illinois Nat'l Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry. Co.*, 294 U.S. 648, 675-79 (1935) (bankruptcy court may enjoin sale of collateral where sale would hinder, obstruct and delay the preparation and consummation of a plan of reorganization); *In re A.H. Robins Co.*, 880 F.2d 694, 701 (4th Cir.), *cert. denied*, 110 S. Ct. 376 (1989) (bankruptcy court had right to enjoin personal injury claimants from suing certain entities other than debtor so as to prevent interference with reorganization plan); *In re Johns-Manville Corp.*, 837 F.2d 89, 93 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988) (permanently enjoining actions against debtor's insurers and insurance policies when such actions "would adversely affect property of the estate and would interfere with reorganization"); *In re A.H. Robins Co.*, 788 F.2d 994, 1008 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986) (bankruptcy court enjoined suits against debtor's co-defendants because successful suits against co-defendants would diminish insurance funds pool and "thereby affect the property of the debtor to the detriment of the debtor's creditors as a whole").

[20] Petitioner alleges that the injunction prevents it from filing an "accurate" tax return. P. Br. 16. This is not so. A worthless-stock deduction is an election, to be taken at the taxpayer's option. 26 U.S.C. § 165 allows the deduction but does not require it.

Petitioner also suggests that the bankruptcy court was without authority to enjoin petitioner from taking a worthless-stock deduction in 1988 because a bankruptcy court has no jurisdiction to adjudicate tax liabilities other than those of the debtor. The Second Circuit recognized that the bankruptcy court was not adjudicating a tax liability but exercising its power "over property of the estate"—that is, over the debtor's NOL. P. App. 22a.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

ALLAN L. GROPPER
WHITE & CASE
1155 Avenue of the Americas
New York, New York 10036
(212) 819-8200
Counsel for Respondent
The Official Committee
of Unsecured Creditors

MAX O. TRUITT, JR.
Counsel of Record
LOUIS R. COHEN
BRYAN E. SLONE
SHARON A. POCOCK
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037
(202) 663-6000
Counsel for Respondent
Cold Spring Shipping, L.P.

August 1, 1991

APPENDICES

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APPENDIX A

11 U.S.C. § 105(a)

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

APPENDIX B

11 U.S.C. § 346(i)

(1) In a case under chapter 7, 12 or 11 of this title concerning an individual, the estate shall succeed to the debtor's tax attributes, including—

(A) any investment credit carryover;

(B) any recovery exclusion;

(C) any loss carryover;

(D) any foreign tax credit carryover;

(E) any capital loss carryover; and

(F) any claim of right.

(2) After such a case is closed or dismissed, the debtor shall succeed to any tax attribute to which the estate succeeded under paragraph (1) of this subsection but that was not utilized by the estate. The debtor may utilize such tax attibutes as though any applicable time limitations on such utilization by the debtor were suspended during the time during which the case was pending.

(3) In such a case, the estate may carry back any loss of the estate to a taxable period of the debtor that ended before the order for relief under such chapter the same as the debtor could have carried back such loss had the debtor incurred such loss and the case under this title had not been commenced, but the debtor may not carry back any loss of the debtor from a taxable period that ends after such order to any taxable period of the debtor that ended before such order until after the case is closed.

APPENDIX C

11 U.S.C. § 346(j)(1), (4)

(1) Except as otherwise provided in this subsection, income is not realized by the estate, the debtor, or a successor to the debtor by reason of forgiveness or discharge of indebtedness in a case under this title.

* * * *

(4) A reduction of a net operating loss or a net operating loss carryover under paragraph (3) of this subsection or of basis under paragraph (5) of this subsection is not required to the extent that the indebtedness of an individual or corporate debtor forgiven or discharged—

(A) consisted of items of a deductible nature that were not deducted by such debtor; or

(B) resulted in an expired net operating loss carryover or other deduction that—

(i) did not offset income for any taxable period; and

(ii) did not contribute to a net operating loss in or a net operating loss carryover to the taxable period during or after which such indebtedness was discharged.

APPENDIX D

26 U.S.C. §§ 382(a), (b)(1), (e)(1), (g), (l)(5)(A)

(a) General rule.—The amount of the taxable income of any new loss corporation for any post-change year which may be offset by pre-change losses shall not exceed the section 382 limitation for such year.

(b) Section 382 limitation.—For purposes of this section—

(1) In general.—Except as otherwise provided in this section, the section 382 limitation for any post-change year is an amount equal to—

(A) the value of the old loss corporation, multiplied by

(B) the long-term tax-exempt rate.

* * * *

(e) Value of old loss corporation.—For purposes of this section—

(1) In general.—Except as otherwise provided in this subsection, the value of the old loss corporation is the value of the stock of such corporation (including any stock described in section 1504(a)(4)) immediately before the ownership change.

* * * *

(g) Ownership change.—For purposes of this section—

(1) In general.—There is an ownership change if, immediately after any owner shift involving a 5-percent shareholder or any equity structure shift—

(A) the percentage of the stock of the loss corporation owned by 1 or more 5-percent shareholders has increased by more than 50 percentage points over

(B) the lowest percentage of stock of the loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period.

(2) Owner shift involving 5-percent shareholder.—There is an owner shift involving a 5-percent shareholder if—

(A) there is any change in the respective ownership of stock of a corporation, and

(B) such change affects the percentage of stock of such corporation owned by any person who is a 5-percent shareholder before or after such change.

(3) Equity structure shift defined.—

(A) In general.—The term "equity structure shift" means any reorganization (within the meaning of section 368). Such term shall not include—

(i) any reorganization described in subparagraph (D) or (G) of section 368(a)(1) unless the requirements of section 354(b)(1) are met, and

(ii) any reorganization described in subparagraph (F) of section 368(a)(1).

(B) Taxable reorganization-type transactions, etc.—To the extent provided in regulations, the term "equity structure shift" includes taxable reorganization-type transactions, public offerings, and similar transactions.

(4) Special rules for application of subsection.—

(A) Treatment of less than 5-percent shareholders.—Except as provided in subparagraphs (B)(i) and (C), in determining whether an

ownership change has occurred, all stock owned by shareholders of a corporation who are not 5-percent shareholders of such corporation shall be treated as stock owned by 1 5-percent shareholder of such corporation.

(B) Coordination with equity structure shifts.—For purposes of determining whether an equity structure shift (or subsequent transaction) is an ownership change—

(i) Less than 5-percent shareholders.—Subparagraph (A) shall be applied separately with respect to each group of shareholders (immediately before such equity structure shift) of each corporation which was a party to the reorganization involved in such equity structure shift.

(ii) Acquisitions of stock.—Unless a different proportion is established, acquisitions of stock after such equity structure shift shall be treated as being made proportionately from all shareholders immediately before such acquisition.

(C) Coordination with other owner shifts.—Except as provided in regulations, rules similar to the rules of subparagraph (B) shall apply in determining whether there has been an owner shift involving a 5-percent shareholder and whether such shift (or subsequent transaction) results in an ownership change.

(D) Treatment of worthless stock.—If any stock held by a 50-percent shareholder is treated by such shareholder as becoming worthless during any taxable year of such shareholder and such stock is held by such shareholder as of the close of such taxable year, for purposes of determining whether an ownership change occurs

after the close of such taxable year, such shareholder—

(i) shall be treated as having acquired such stock on the 1st day of his 1st succeeding taxable year, and

(ii) shall not be treated as having owned such stock during any prior period.

For purposes of the preceding sentence, the term "50-percent shareholder" means any person owning 50 percent or more of the stock of the corporation at any time during the 3-year period ending on the last day of the taxable year with respect to which the stock was so treated.

* * * *

(*l*) Certain additional operating rules.—For purposes of this section—

* * * *

(5) Title 11 or similar case.—

(A) In general.—Subsection (a) shall not apply to any ownership change if—

(i) the old loss corporation is (immediately before such ownership change) under the jurisdiction of the court in a title 11 or similar case, and

(ii) the shareholders and creditors of the old loss corporation (determined immediately before such ownership change) own (after such ownership change and as a result of being shareholders or creditors immediately before such change) stock of the new loss corporation (or stock of a controlling corporation if also in bankruptcy) which meets the requirements of section 1504(a)(2) (determined by substituting "50 percent" for "80 percent" each place it appears).

APPENDIX E

Treasury Regulation § 1.1502-79(a)(1)(ii)

§ 1.1502-79. Separate return years.—(a) *Carryover and carryback of consolidated net operating losses to separate return years.*—(1) *In general.*

* * * *

(ii) If a corporation ceases to be a member during a consolidated return year, any consolidated net operating loss carryover from a prior taxable year must first be carried to such consolidated return year, notwithstanding that all or a portion of the consolidated net operating loss giving rise to the carryover is attributable to the corporation which ceases to be a member. To the extent not absorbed in such consolidated return year, the portion of the consolidated net operating loss attributable to the corporation ceasing to be a member shall then be carried to such corporation's first separate return year.

APPENDIX F

Proposed Treasury Regulation § 1.1502-20(g)(1)-(2)

* * * *

(g) *Reattribution of subsidiary's losses to common parent*—(1) *Reattribution rule.* If a member disposes of stock of a subsidiary and the member's loss would be disallowed under paragraph (a)(1) of this section, the common parent may make an irrevocable election to reattribute to itself any irrevocable election to reattribute to itself any portion of the net operating loss carryovers and net capital loss carryovers attributable to the subsidiary (and any lower tier subsidiary) without regard to the order in which they were incurred, provided the amount reattributed does not exceed the amount that would be disallowed if an election under this pargaraph (g) were not made. The common parent succeeds to the reattributed losses as if the losses were succeeded to on the day of the disposition in a transaction to which section 381 applies. Any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3)) in connection with the disposition will not be taken into account under section 382 with respect to the reattributed losses.

(2) *Insolvency limitation.* Losses of a subsidary may not be reattributed under this paragraph (g) to the extent that the subsidiary and all higher tier subsidiaries are insolvent within the meaning of section 108(d)(3) at the time of the disposition. For purposes of determining insolvency, preferred stock of a subsidiary that is not owned by members is treated as a liability to the extent of the amount of preferred distributions to which the stock would be entitled if the subsidiary were liquidated on the date of the disposition.